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FISCAL IMPACT STATEMENT

LS 6147

BILL NUMBER: HB 1371

NOTE PREPARED: Jan 5, 2007

BILL AMENDED:

SUBJECT: Medical Expense Deduction.

FIRST AUTHOR: Rep. Stevenson

FIRST SPONSOR:

BILL STATUS: As Introduced

FUNDS AFFECTED: ☒ GENERAL
☒ DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: The bill provides a deduction from Adjusted Gross Income for eligible medical expenses.

Effective Date: January 1, 2007 (retroactive).

Explanation of State Expenditures: The Department of State Revenue (DOR) would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate the deduction for eligible medical expenses. The DOR's current level of resources should be sufficient to implement these changes.

Explanation of State Revenues: *Summary:* The bill would reduce state Adjusted Gross Income (AGI) Tax liabilities for individual taxpayers who have out-of-pocket medical care expenses and insurance premium expenses that are eligible for the federal itemized deduction for medical and dental expenses. The revenue loss due to this bill could potentially total as much as \$120 M in FY 2008 and \$129 M in FY 2009. The revenue loss could potentially increase by 5% to 10% annually thereafter based on recent annual trends in medical expenses and health insurance premiums.

Background: The bill establishes a deduction from Indiana AGI for medical care expenses paid by an individual taxpayer that are deductible under the federal itemized deduction for medical and dental care expenses. The deduction from Indiana AGI is limited to eligible expenses paid during the taxable year exceeding \$300 but not in excess of: (1) \$3,000 for a single filer with no dependents; or (2) \$3,000 multiplied by the total number of the following individuals: (a) the taxpayer, (b) the taxpayer's spouse, and (c) each of the taxpayer's dependents. For example, a joint filer with two dependents would be entitled to deduct annual

medical expenses in excess of \$300 and up to \$12,000. The expenses must be for the care of the individual, the individual's spouse, or dependents of the individual.

Expenses that are eligible for the federal itemized deduction include: (1) out-of-pocket medical care expenses and (2) premiums paid by the taxpayer for health insurance coverage; Medicare Part B and Part D coverage; Medigap or Medicare Supplement insurance; or long-term care insurance. Eligible health insurance premiums include: (1) premium expenses of individuals purchasing private non-group health coverage and (2) employee premium expenses related to employer-provided health coverage as long as the employee premiums are not paid with "pre-tax" income. This would also include premiums paid by individuals for coverage through the Indiana Comprehensive Health Insurance Association (ICHIA). Under the bill, the deduction could not be claimed for premiums paid for "Indiana Partnership" long-term care insurance as these premiums already may be deducted in computing Indiana AGI. The deduction is effective beginning tax year 2007. As a result, the fiscal impact could potentially begin in FY 2008.

The table below reports the estimated revenue loss due to the deduction by expense type. The fiscal impact of this deduction could potentially increase 5% to 10% annually based on recent annual trends in medical expenses and health insurance premiums. The growth rate would depend on a number of factors including year-to-year changes in health insurance coverage rates, employee participation in pre-tax payment plans, and the extent to which employers providing health insurance benefits share the cost of premium increases with covered employees. It is also important to note that the revenue loss could potentially be reduced to the extent that taxpayers have expenses in multiple categories that exceed the maximum deduction limit.

Type of Expense	Revenue Loss from Expense Deduction	
	FY 2008	FY 2009
Employer-Provided Health Coverage	\$44.3 M	\$45.2 M
Out-of-Pocket Medical Care Expenses	31.8 M	33.4 M
Medicare Premiums	29.4 M	35.0 M
Medigap/Medicare Supplement Coverage	6.8 M	7.1 M
Long-Term Care Coverage	3.6 M	4.0 M
Private Non-Group Health Coverage	3.6 M	3.7 M
ICHIA Coverage	0.8 M	0.8 M
Total	\$120.3 M	\$129.2 M

Estimation Background: Deductible expense and premium totals are estimated based on *Census 2000* population counts for Indiana and statistical results from various health expense and insurance surveys. Information used for the different estimates is outlined below.

Employer-Provided Coverage: Deductible premiums for employees with employer-provided coverage are estimated based on survey research suggesting that 65% to 70% of the population under the age of 65 is covered by employer-provided health insurance, with the current employee share of premium cost averaging about \$630 for single coverage and \$2,600 for family coverage. This estimate is also based on survey

research estimating that about 28% of workers are employed by businesses that offer "cafeteria plans" enabling workers to pay for employer-provided health insurance benefits with "pre-tax" income. Thus, the estimated revenue loss attributable to premiums paid by workers for employer-provided coverage is adjusted to account for this group. To do so, it is assumed that government workers and 28% of private sector employees currently pay health insurance premiums with "pre-tax" income.

Out-of-Pocket Expenses: The deductible out-of-pocket expense total is estimated based on survey research estimating the distribution of out-of-pocket expenses by marital/family status.

Medicare Premiums: Deductible premium totals relating to Part B and Part D coverage are generated utilizing 2005 enrollment totals for Indiana and forecast growth rates in national enrollment. Part B premiums are estimated based on the established monthly premium for 2006 assuming the premium growth rate experienced from 2000 to 2006. Part D premiums are estimated based on the average premium for plans operating in Indiana assuming the same growth rate as for Part B premiums.

Long-Term Care Coverage: The deductible premium total for long-term care coverage is estimated based on survey research estimating that Indiana market penetration rates for long-term care insurance ranges from 6% to 9%, with a reported average premium of about \$1,500 per year. The estimate also excludes Indiana Partnership policies which are covered by a separate tax deduction under current statute. The estimate assumes an average deduction of \$900 since the federally deductible premium is limited based on the age of the taxpayer. The estimate also excludes Indiana Partnership policies which are covered by a separate tax deduction under current statute.

Medigap/Medicare Supplement Coverage: Deductible premiums for Medigap/Medicare Supplement coverage are estimated based on survey research suggesting that approximately 21% of the population 65 and older purchase this insurance coverage. The estimate assumes an annual premium of \$1,500.

Private Non-Group Health Coverage: The deductible premium total for private non-group coverage is estimated based on survey research suggesting that roughly 5% of the population under the age of 65 is covered by such insurance policies, with current annual premiums averaging about \$2,700 for single coverage and \$5,300 for family coverage. In addition, this is adjusted to account for individuals who purchase private non-group coverage but already utilize the deduction from federal gross income for self-employed health insurance premiums. In 2004, almost 73,000 federal filers residing in Indiana claimed \$349.0 M in health premiums under this deduction. These premiums are excluded from the estimate.

ICHIA Coverage: Deductible ICHIA premiums are estimated based on annualized premium totals reported for 2004 and 2005, and the January-September 2006 period, and average ICHIA client totals for the same period.

Explanation of Local Expenditures:

Explanation of Local Revenues: The proposed deduction could potentially decrease taxable income. As a result, counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) could potentially experience a significant decrease in revenue from these taxes.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties with local option income taxes.

Information Sources: OFMA Income Tax databases, 1998-2004; *Census 2000, Age Distribution of Population, Indiana*, Summary File 1, <http://www.census.gov/>; Agency for Healthcare Research and Quality. *Full Year Consolidated Data File (HC-020): 2001-2004. Medical Expenditure Panel Survey Household Component Data*, <http://www.meps.ahrq.gov/>; Kaiser Family Foundation, *The Economic Downturn and Changes in Health Insurance Coverage 2000-2003*, September 2004, <http://www.kff.org/>; Kaiser Family Foundation, *Update on Individual Health Insurance*, August 2004; Kaiser Family Foundation, *Employer Health Benefits Annual Survey*, 2006; Kaiser Family Foundation, *Private Long-Term Care Insurance: A Viable Option for Low and Middle-Income Seniors?* 2006; Bureau of Labor Statistics, *Employment, Hours & Earnings (NAICs Based Data) - Indiana: September 2005*; Health Insurance Institute of America (HIAA), *Long-Term Care Insurance in 1997-1998*; HIAA, *Long-Term Care Insurance in 1998-1999*; HIAA, *Long-Term Care Insurance in 2002*; HIAA, *Tax Deductibility of Long-Term Care Insurance Premiums*, March 2000; Milbank Memorial Fund, *Long-Term Care for the Elderly with Disabilities*, August 2000; Indiana Long-Term Care Insurance Program statistical summaries; Centers for Medicare and Medicaid Services, Medicare Enrollment and Premium information, <http://www.cms.hhs.gov/>; Indiana Department of Insurance, *Senior Health Insurance Information Program*, <http://www.in.gov/idoi/shiip>.

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